No. 15920

United States
COURT OF APPEALS
for the Ninth Circuit

EINAR GLASER and DOROTHY GLASER,

Appellants,

-vs-

MARGUERITE L. CONNELL,

Appellee.

BRIEF OF APPELLEE

Appeal from the United States District Court for the Western District of Washington, Northern Division.

HON. GEO. H. BOLDT, Judge.

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Appeal from the United States District Court for the Western District of Washington, Northern Division.

HON. GEO. H. BOLDT, Judge.

For the second time now Marguerite L. Connell, an 83 year old widow is before an appellate court defending her home from foreclosure on this same note and mortgage. Appellants first sought foreclosure in the Washington courts as holders in due course; only to lose their preferred status which would have "insulted" them from the fraud of Errion. *Glaser v. Connell* (1955), 47 Wn. 2d 622, 289 P.2d 364. This time they have at-

tacked with a foreclosure suit commenced in the United States District Court for the Western District of Washington. This time they come, not as holders in due course, but as mere assignees of the note and mortgage which they blandly stipulated in writing were obtained in the first instance from Appellee by fraud of their assignor. From the judgment dismissing their suit Appellants have appealed.

Appellants have raised only two basic questions on this appeal:

First, whether Case 3556—*Errion v. Connell* (9 Cir., 1956), 236 F.2d 447, is res judicata and a bar to Appellee asserting her defense of fraud in the case at bar; and

Second, whether the district court erred in refusing to apply in Appellants' favor the equitable doctrine of comparative innocence so that they might have prevailed in spite of the fact they were naked assignees of fraudulent paper.

RES JUDICATA NOT INVOLVED

Because Appellants in their brief have dwelt more upon the activities of the "fabulous rascal" than upon the precise nature of Case 3556 it is incumbent upon Appellee to present an analysis of that former case and show how it cannot possibly constitute a bar to Appellee here under any theory of res judicata, collateral estoppel, merger or election of remedies; all being contentions which Appellants have asserted in a conglomerate fashion.

Since Appellants were dismissed from Case 3556 prior to entry of judgment in favor of Appellee and against others the Appellants are "strangers" to that judgment.

An inspection of Exhibit 4 and a review of this Court's recent opinion in *Errion v. Connell* (9 Cir., 1956), 236 F.2d 447, will show that Case 3556 was an action brought by Appellee as plaintiff against Appellants and others as defendants charging that they conspired in a scheme to defraud Appellee of her securities and other property in violation of Section 10(b) of the Securities Exchange Act of 1934, as amended (15 USCA § 78a) and Rule X-10B-5 as promulgated by the Securities and Exchange Commission (17 C.F.R. § 240, 10B-5). This note and mortgage were a subject of that action and the note (but not mortgage) was cancelled by the Court "so far only as the title or interest of Holdorf Oyster Corporation is concerned" pursuant to authority to do so under Section 29(b) of the Securities Exchange Act of 1934 (15 USCA § 78cc).

However, the fact which is so essential in considering the effect of Case 3556 upon the one at bar and the fact upon which Appellants in their brief are "loudly silent" is that Appellants were dismissed from Case 3556 one week prior to judgment being entered in favor of Appellee and against the other defendants. The effect of this situation is to make Appellants total strangers to the judgment rendered in favor of Appellee and against the others in Case 3556.

Where a defendant is dismissed from an action before judgment the effect of the dismissal is the same as if the defendant had never been made a party.

Armbruster v. Hoff (Sup. Ct., Colo., en banc, 1953), 128 Colo. 74, 260 P.2d 601.
Holt Mfg. Co. v. Collins (1908), 154 Cal. 265, 97 Pac. 516, 519.
Page v. W. W. Chase Co. (1904), 145 Cal. 578, 79 Pac. 278.

Section 79 of the Restatement, Judgments, defines the conditions under which a party may claim a former judgment to be res judicata. In point is comment "f" under Section 79 which reads in part:

> "A person who originally was a party or who has intervened in the proceeding but who, before judgment, is dismissed from the action, or is permitted to withdraw from it, is not affected by the judgment or by the decisions of any issues which have led to it."

Otherwise stated, there were two separate and distinct judgments rendered in Case 3556; one dismissing Appellants on January 10, 1955 and a second in favor of Appellee and against other defendants a week later on January 17, 1955 (Ex. 4). Appellants cannot claim anything for the second judgment to which they are total strangers. Nor can Appellants claim res judicata as to the second judgment through their assignor Holdorf Oyster Corporation who was a party defendant because with the assignment having been made prior to commencement of Case 3556 Appellants were never in privity was their assignor. Restatement, Judgments, Sec. 104; *Dakota Life Ins. Co. v. Midland Nat. Bank* (8 Cir., 1927), 18 F.2d 903, 904.

Dismissal of Appellants in Case 3556 is not basis for res judicata since different proof was required there than in case at bar.

Because different burdens of proof were required in Case 3556 than in the case at bar the former action which resulted in dismissal of Appellants cannot properly serve to bar Appellee from defending the present foreclosure suit.

It is well settled that in determining whether a former judgment is a bar to a subsequent action it is necessary to inquire whether the same evidence would have maintained both such actions. *Buddress v. Schafer* (1895), 12 Wn. 310, 41 Pac. 43. This is not only the best but is the most infallible criteria. *Curtis v. Crooks* (1937), 190 Wn. 43, 66 P.2d 1140, 1144. The fact that similar relief as here was sought in the former action makes no difference. *Viator v. Stone* (Miss., 1947), 29 So. 2d 274, 276.

Differences of required proof in Case 3556 and the one here are many. The most important difference is that in Case 3556 in order for Appellee to have had the note and mortgage cancelled she had to prove as she had properly alleged that Appellants as assignees of those instruments acquired them with *actual knowledge* of the fraud on the part of their assignor which rendered them voidable. In the case at bar in order to succeed Appellee had only to prove Appellants took by assignment (which they admitted) and that the note and mortgage were obtained by fraud of their assignor (which they also admitted).

In Case 3556 the district court took jurisdiction only by reason of a sale of securities in violation of Section 10(b) of the Securities Exchange Act of 1934 and the Commission's Rule X-10B-5. *Fratt v. Robinson* (9 Cir., 1953), 203 F.2d 627. As to cancellation of the note and mortgage Congress enacted Section 29(b) of the Securities Exchange Act of 1934 (15 USCA § 78cc(b)) which conferred jurisdiction upon the district court to cancel or render void instruments made in violation of the Act and Rule. However, in conferring this power on the court Congress expressly restricted its applicability so far as assignees of contracts were concerned to those situations where it could be proven that the assignees acquired such contracts with *actual knowledge* of the facts which rendered them in violation of the Act or Rule. The pertinent part of Section 29(b) of the Securities Exchange Act of 1934 (15 USCA § 78cc(b)) reads:

> "(b) Every contract made in violation of this title or of any rule or regulation thereunder . . . shall be void
>
> "(1) . . .
>
> "(2) As regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule, or regulation . . ."

Thus, Appellee in Case 3556 in order to cancel the note and mortgage and remove the cloud from the title to her Seattle home was required to allege and prove that not only were the note and mortgage obtained from her by fraud of Holdorf Oyster Corporation, Ap-

pellants' assignor but also that Appellants when acquiring the note and mortgage had *actual knowledge* of their assignor's fraud. In Case 3556 Appellee proved the note and mortgage were fraudulently obtained from her but failed to prove the most difficult but absolutely essential fact that Appellants took the instruments with *actual knowledge* of the fraud. This was the cogent reason why Appellants were dismissed from the case. Appellee had also alleged in Case 3556 that Appellants conspired with the other defendants in the scheme to defraud her of valuable securities including the note and mortgage. She failed to tie Appellants into the conspiracy which she established against the other defendants. Failure of this proof only saved Appellants from being tagged with the $83,077.49 judgment entered against the other defendants. Even if Appellee had established Appellants as conspirators the Court would still have lacked jurisdiction to declare the note and mortgage void, short of proof of *actual knowledge* of the fraud on the part of Appellants.

Ironically, in Case 3556 it was the very necessity for Appellee to bring home *actual knowledge* of the fraud to Appellants which won for them a dismissal from that case but which at the same time made it inappropriate to serve as a bar to Appellee in this case. It must be remembered that almost simultaneously with Appellee's prosecution of her fraud action in Case 3556 the Appellants as plaintiffs were seeking to foreclose this note and mortgage as holders in due course in the Superior Court of the State of Washington for the County of King (Tr. 21, F. 11). The difference in proof was

clearly demonstrated when in Case 3556 Appellee was unable to reach Appellants with proof of fraud in connection with the execution of this note and mortgage but successfully defended the suit brought by Appellants in the state court by showing Appellants not to be holders in due course without proof of actual knowledge of fraud on their part.

Here, the Appellants have come into the district court as assignees only of the note and mortgage; they having been stripped of the status of holders in due course by their foreclosure suit in the state court. *Glaser v. Connell* (1955), 47 Wn. 2d 622, 289 P.2d 364. The state court action would have been res judicata against these Appellants here had not the complaint been dismissed without prejudice to give Appellants opportunity to either secure the lacking endorsement on the note and return as holders in due course or sue as they have as assignees. It means nothing in the case at bar that lack of *actual knowledge* of the fraud on part of Appellants is established. It is axiomatic that assignees can have no greater rights or title than their assignor and that they take notes and mortgage subject to the defense that the same were induced by fraud practiced by their assignor. *Willett v. Central Yakima Ranch Co.* (1913), 126 Wn. 587, 219 Pac. 20.

Other differences in necessary burdens of proof exist between Case 3556 and this one. For instance, proof of fraud in connection with the use of the mails or an instrumentality of interstate commerce was essential in Case 3556 for jurisdiction but not in the case at bar. Also, Appellee's proof that the procurement of the note

and mortgage from Appellee was a violation of Rule X-10B-5 of the Securities and Exchange Commission was considerably less than proof of common law fraud in the State of Oregon where the fraud was perpetrated. Compare Rule X-10B-5 (17 C.F.R. § 240-10B-5) with the nine elements of fraud set forth in *Conzelmann v. N. W. P. & D. Prod. Co.* (1950), 190 Or. 332, 225 P.2d 757. These, and perhaps further differences in proof, make it improper for the judgment of dismissal in Case 3556 to operate under the doctrine of res judicata as a bar to Appellee asserting in this case the defense of fraud.

Still, a further and statutory reason exists as to why any judgment in Case 3556 should not operate as a bar to Appellee in this case. Section 28 of the Securities Exchange Act of 1934 (15 USCA § 78bb) reads:

> "(a) The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this chapter shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of. . . ."

In Case 3556 Appellee maintained her tort action for damages (not pecuniary restitution) under the Securities Exchange Act of 1934 upon the understanding, as above stated, that the remedy she there sought and obtained was a remedy in addition to any other rights or remedies at law or in equity which she might otherwise have had. One of these other rights was to defend

Appellant's second foreclosure suit upon the fraud of their assignor without being barred by the exercise of her additional remedy in Case 3556.

No essential facts were litigated in Case 3556 that could collaterally estop Appellee in defending this case.

While Appellants in their brief have not mentioned collateral estoppel by name they have intimated the doctrine might be applicable. Appellee wishes to meet such contention.

It is only where a question of fact essential to the judgment is actually litigated and determined by a valid and final judgment that the determination is conclusive between the parties on different causes of action. *Tyler Mining Co. v. Sweeney* (9 Cir., 1893), 54 Fed. 284; Restatement, Judgments, Section 68.

So far as this note and mortgage were involved there were only two essential facts litigated and determined in Case 3556 as between Appellee and Appellants and from which a judgment of dismissal was entered in favor of Appellants. The first fact was whether or not Appellants had actual knowledge of the fraud which tainted the instruments and the second was the fraud itself. The Court found in favor of Appellants on the first fact and dismissed them and later found in favor of Appellee against other defendants on the second fact. A third, but irrelevant fact was also put to rest in Case 3556. That fact was that Appellants were not conspirators with the other defendants in defrauding Appellee. The judgment of dismissal in favor of Appellants does

collaterally estop Appellee from re-litigating the issue of actual knowledge and the issue of conspiracy but nothing more.

The only useful purpose in the case at bar for which the fact of lack of actual knowledge and lack of conspiracy could serve Appellants (and not against them) would be as evidence—"mediate data" to prove good faith; an element to the doctrine of comparative innocence which is being asserted by Appellants. Lack of actual knowledge was admitted and found by the district court in this case but it in itself was not sufficient to avoid the ultimate finding of lack of good faith in the part of Appellants.

Thus, any express or implied findings of fact in Case 3556 which Appellants by reply might conjure cannot be used by Appellants to collaterally estop Appellee because such would not have been essential findings of an ultimate fact. At best, such facts would constitute only evidentiary facts—"mediate data" in the former case and not be of a quality to form the basis for a collateral estoppel. Or, perhaps, if by any chance such other facts be regarded as ultimate in Case 3556 they could only be useful in the case at bar as "mediate data." In either event, such other facts would be inadequate to establish collateral estoppel. *The Evergreens v. Nunan* (2 Cir., 1944), 141 F.2d 927, 152 ALR 1187.

We might mention here that there is no merit in Appellants' claim that the court in Case 3556 in cancelling the note as to Holdorf Oyster Corporation only in the January 17, 1955 judgment in favor of Appellee

inferentially constituted a finding that the note as then held by Appellants was valid. The only inference that could properly be drawn from that situation, if it is competent to draw any inference, is that Appellants had been dismissed from the case a week before because of failure of Appellee to bring home *actual knowledge* to them and that the Court cancelled the fraudulent paper only so far as it was able; not resurrecting Appellants' holder in due course status nor giving them a "bouquet" for holding paper tainted with fraud.

Appellee's unsatisfied judgment against Errion and others did not merge note and mortgage so as to bar her defense to Appellants' foreclosure suit.

In Case 3556 Appellee has a judgment against Holdorf Oyster Corporation, Appellants' assignor in amount of $83,077.48 which remains unsatisfied except to the extent of $5,747.57 (Tr. 21). Although that judgment certainly merged the note and mortgage so far as Holdorf Oyster Corporation is concerned it definitely did not do so as to these Appellants. If it had they would not have been able to maintain the present foreclosure suit.

Freeman on Judgments (4th Ed) in § 562 at page 1193 of Volume 2 states the rule authoritatively and clearly:

> "Though a judgment may merge a claim or cause of action so far as the parties to the action and their privies or those represented by them are concerned, as to third persons with respect to whom it is not res judicata, the claim or cause of action, though embodied in a written contract such as a note or mortgage, may still retain its existence and form the basis of a new action."

See also:

Petri v. Manny (1918), 99 Wn. 601, 170 Pac. 127.
Harrison v. Remington Paper Co. (8 Cir., 1905), 140 Fed. 385, 394.

As we have already shown, Appellants were strangers to the Appellee's judgment and further, cannot in any way be said to be in privity with Holdorf Oyster Corporation. If the later was true the Appellee's judgment in Case 3556 which Appellants now claim bars Appellee from defending the case at bar would have been a complete bar against Appellants in the first instance maintaining this suit.

Appellee's judgment in Case 3556 which included damages for Errion encumbering Appellee's home did not bar Appellee in defending foreclosure suit by either election or merger.

An unusual situation confronted the district court in Case 3556 when it came to awarding damages to Appellee for the fraud perpetrated upon her by Errion, Holdorf Oyster Corporation and the other defendants (except Appellants). Appellants had been dismissed from the case. They held the note and mortgage at least by assignment and perhaps as holders in due course. If the latter, Appellee faced losing her home unless she could pay $16,000 plus interest which Appellants were demanding in a foreclosure suit then pending in the Superior Court of the State of Washington. If Appellants were not holders in due course then probably after considerable vexation and expense Appellee could and would prevent foreclosure. In order to assure Appellee of adequate damages the trial judge, William J.

Lindberg, in Case 3556 included in the calculation of damages to be awarded against Errion, et al, $16,000 plus accrued interest to January 17, 1955 on the note in amount of $4,314.68 for a total of $20,314.68 in making up a total award to Appellee of $83,077.48 (Tr. 21). This judgment was not against Appellants and doesn't even to this day concern them.

There never was any opportunity for Appellee to have elected between clearing her home of this fraudulent encumbrance and taking a judgment reduced by $20,314.68 or recognizing the validity of the note and mortgage and run her chances of collecting a judgment from Errion. Appellee was fighting on all fronts. It appears unconscionable to permit Appellants as "bad faith" holders by assignment of fraudulent paper to take over Appellee's home by foreclosure upon the proposition that she elected (when in fact she didn't and couldn't) to accept an unsatisfied judgment against Errion instead of a clear title to her home. Neither any theory of merger nor election of remedies require such an unfair result.

Appellants' position is no different than the person who acquires personal property from another who had previously converted it to his use from that of the true owner. In that situation, even where in a former action the true owner has secured a judgment for the full value of the property converted against the person who converted it, such a judgment cannot be pleaded as a bar so as to prevent the true owner, from suing and recovering the property from the person holding it.

Schwegman v. Neff (App. Ct., Ind., en banc, 1940), 218 Ind. Rep. 63, 27 N.E. 2d 397.

Ledbetter v. Embree (1895), 12 Ind. App. 617, 40 N.E. 928.

Freeman on Judgments (4th Ed), Section 577.

Neither does the election of remedy rule assist Appellants in taking advantage of Appellee by reason of her holding an unsatisfied judgment against Errior, et al., to which they are strangers.

Election of one remedy does not bar another unless they are inconsistent. *Union Trust Co. of Spokane v. Wiseman* (D. Ct., Ore., 1926), 10 F.2d 558. At best the doctrine of election of remedies is a harsh and now largely obsolete rule, the scope of which should not be extended. *Friederechsen v. Renard* (1917), 247 U.S. 207, 62 L. Ed. 1075. What is most important, however, is that because the doctrine of election of remedies is so similar to the doctrine of estoppel, the modern rule is that even when applicable the doctrine of election of remedies will not be applied until it is first shown by the party asserting such doctrine that he has been injured because of such election. *Pacific Coast Cheese v. Security First Nat. Bank* (Calif. S. Ct., en banc, 1955), 45 Cal. 2d 75, 286 P.2d 353; *Lake v. New York Life Ins. Co.* (4 Cir., 1955), 218 F.2d 394, 400. Obviously, Appellants cannot be injured by reason of Appellee holding an unsatisfied judgment against the "fabulous rascal."

Where two different actions are asserted against different parties seeking but one satisfaction such actions

are not inconsistent and one cannot serve as a bar to the other under the doctrine of election of remedies.

> *Title Guarantee & Trust Co. v. McIlwain* (9 Cir., 1934), 73 F.2d 755.
>
> *Foshay Trust & Savings v. Public Utilities* (8 Cir., 1933), 64 F.2d 665, cert. denied in 78 L. Ed. 566.
>
> *Lake v. New York Life Ins. Co.* (4 Cir., 1955), 218 F.2d 394, 400.
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> *Perkins v. Benguet Consol. Mining Co.* (D. Ct., App. Calif., 1942), 55 Cal. App. 2d 720, 132 P.2d 70, 90.
>
> *Farmers and Merchants Bank v. Universal CIT* (Utah, 1955), 289 P.2d 1045.

Of course, the case cited by Appellants, namely, *Hein v. Chrysler Corporation* (1954), 45 Wn. 2d 586, 277 P.2d 708, is clearly distinguishable from the case at bar in that both the Federal Court former action and the State Court second action were both against the same defendant; the plaintiff merely wanting to try the same cause of action on two theories and take the larger of two verdicts.

Still a further and complete answer to this problem of both merger and election of remedy is found in Section 28 of the Securities Exchange Act of 1934 (15 USCA § 78bb), as set forth on page 9 of this brief. It declares that Appellee's Case 3556 in which she secured her judgment was an additional remedy to any and all other rights and remedies which she might otherwise have had at law or in equity. At least Congress said she could assert her defense in this case until she had secured full satisfaction of that judgment. The latter she has not done.

DOCTRINE OF "COMPARATIVE INNOCENCE" NOT INVOLVED

In this case the Appellants, after having lost their standing as holders in due course of this note and mortgage in their previously maintained state court action are now seeking to gain the equivalent of their lost status under the equitable doctrine of comparative innocence. They say, that by reason of an estoppel in pais that Appellee cannot claim as a defense that the note and mortgage were fraudulently obtained from her because by Appellee's own negligence she executed and delivered the instruments to Errion making it possible for him to later assign such to them. As a consequence, they say, that as between two innocent persons—Appellants on the one hand and Appellee on the other, that they should prevail and be permitted to foreclose upon the note and mortgage in spite of being at best naked assignees of fraudulent paper.

Appellants did not act in good faith in acquiring the note and mortgage and are not in a position to even urge an estoppel in pais.

The trial court found upon competent evidence the following facts, among others (Tr. 19, F. 6):

> "That plaintiffs (Appellants) exercised complete indifference and neglect and did not act in good faith at time they voluntarily purchased said note and mortgage from E. R. Errion in August of 1951 paying $16,000 to Holdorf Oyster Corporation for the benefit of E. R. Errion. Plaintiffs relied upon other transactions with E. R. Errion and not said mortgage to secure repayment of their loan to E. R.

> Errion. That plaintiffs did not procure a valid endorsement of the payee of said note at time they acquired it from E. R. Errion. Prior to or at time of acquiring said note and mortgage, plaintiffs knew the note was in default as to the payment of the first year's interest. At said time, plaintiffs made no inquiry or investigation as to title, taxes or ability of Marguerite L. Connell to pay said note when due. . . . Defendant, Marguerite L. Connell, was at all relevant times living upon said real property which plaintiffs knew."

As a matter of law with the above findings of fact which Appellants concede are supported by the evidence, Appellants do not have the "clean hands" sufficient to come into a court of equity and urge the equitable doctrine of comparative innocence; more technically called an estoppel in pais.

The necessity for Appellants to first show themselves free of negligence in urging their own affirmative excuse by way of comparative innocence for not being bound by the title of their assignor is well established as the law of the State of Washington. In the case of *Liska v. Beckmann* (1932), 168 Wn. 489, 494, 12 P.2d 599, the appellant there had purchased a mortgage from Osner & Melhorn, Seattle mortgage dealers, who represented the mortgage to be a first mortgage. Had an investigation been made a prior mortgage would have appeared of record although the assignment of the prior mortgage would not have so appeared. The mortgagee of the prior mortgage did not know of a renewal nor of an assignment of mortgage and had no contact with the appellant. The Supreme Court of Washington in not only refusing to apply the doctrine of comparative innocence

to assist the appellant because of her own negligence also held that the case of *Kiley v. Bugge* (1931), 165 Wn. 677, 5 P.2d 1038, which Appellants here rely so heavily upon, was not in point. The Court said:

> "The doctrine that, as between two innocent parties, the person who made the fraud possible should suffer the loss, can not be successfully invoked in behalf of the appellant. Had appellant, as we said above, exercised the care required of her in the purchase of the mortgage she seeks to foreclose, she would have discovered the recorded mortgage of 1920 existing as a prior lien against the property. Respondent was in no position to warn the appellant. She did not know that Bjornstad had executed a new mortgage to Osner & Melhorn, and she did not know that that mortgage had been assigned by Osner & Melhorn to the appellant.
>
> "*Kiley v. Bugge,* 165 Wash. 677, 5 P.2d 1038, is not in point. . . ."

Furthermore, carelessness is evidence of lack of good faith and lack of good faith for any reason also prevents a party from asserting the doctrine of comparative innocence. In *Thorp Finance Corp. v. Le Mire* (1953), 264 Wis. 220, 58 N.W. 2d 641, 44 ALR 2d 189 (at p. 195), the Court said:

> "Since the doctrine of estoppel in pais is founded upon principles of morality and fair dealing and is available only for the protection of claims made in good faith, the party setting up an estoppel is himself bound to the exercise of good faith in the transaction and in his reliance upon the words or conduct of the other party. . . .
>
> "Good faith is generally regarded, however, as requiring the exercise of reasonable diligence to learn the truth, and, accordingly estoppel is denied where the party claiming it was put on inquiry as

to the truth and had available means for ascertaining it, at least where the element of actual fraud is absent."

In the case at bar, Appellants knew the note was in default and that Appellee was living in the house upon which the mortgage rested. On the other hand Appellee had not realized she had delivered a mortgage to Errion (Tr. 73) and knew nothing about its assignment nor about the Appellants. Appellants at time of taking the note and mortgage by assignment had only to reach for a telephone or write a letter of inquiry (as they later did) in order to have had revealed to them the whole sad affair.

When the effect is to divest a person of an estate in land it is the policy of the State of Washington that the doctrine of estoppel in pais should be cautiously applied, and then only upon the most cogent and convincing evidence. *Finley v. Finley* (1953), 43 Wn. 2d 755, 264 P.2d 246, 252; *Murray v. Briggs* (1902), 29 Wn. 245, 259, 69 Pac. 767. The actual possession of real property gives notice to a mortgagee of whatever a prudent and reasonable inquiry would have revealed. *Nicholas v. Debritz* (1934), 178 Wn. 375, 35 P.2d 29. Having made no investigation or inquiry before taking the note and mortgage by assignment Appellants acted at their own peril and cannot now claim freedom from negligence or bad faith. *Di Giovacchini v. Teich* (N.J., 1943), 30 Alt. 2d 815; *Marsinger v. Geering* (N.J., 1940), 16 Atl. 2d 338. It is even bad faith to take a note knowing that the first installment of interest is past due and unpaid. *Fidelity Trust Co. v. Whitehead* (N.C., 1914), 80 S.E. 1065.

In addition to being negligent and acting with lack of good faith the court below found Appellants to be indifferent to the mortgage as a security in that they were looking for their security to an anticipated opportunity to exercise an off-set with Errion on real estate commission which they were to pay him (Tr. 102). Since Appellants were indifferent at time of acquisition they can hardly complain now just because their anticipated offset with Errion did not materialize. Equity should leave Appellants exactly where they put themselves by their own negligence, lack of good faith and indifference.

Since Appellants have not exhausted legal remedy of securing endorsement and proceeding as holders in due course they cannot assert equitable doctrine of comparative innocence.

Appellants lost their standing as holders in due course because they had not procured an effective endorsement to the note. They had a right to such endorsement and under the law merchant could compel such. RCW 62.01.049. *Hanson v. Roesch,* 104 Wn. 257, 176 Pac. 349. In the previous suit the state court in effect dismissed Appellant's cause without prejudice to give them an opportunity to secure such endorsement and regain their status, if they could, as holders in due course. Instead of properly seeking their remedy at law as was clearly pointed out to them Appellants come to a court of equity and seek to substitute for their lost holder in due course status the equitable doctrine of comparative innocence. In doing so, Appellants have neither alleged nor have attempted to prove that they

had no clear, plain nor adequate remedy at law. For this reason Appellants have not qualified to assert the equitable defense (or excuse) of comparative innocence or invoke the equitable jurisdiction of the district court.

An available legal remedy must be exhausted before resort can be had in a court of equity; particularly where payment of money is sought. *Heine v. Levee Comrs.* (1874), 19 Wall. (U.S.) 655, 22 L. Ed. 223. In fact, the Judiciary Act of 1789 limits the equity jurisdiction of the Federal courts to those cases only where it is first shown that the party does not have an adequate and complete remedy at law. *Schoenthal v. Irving Trust Co.* (1931), 287 U.S. 92, 77 L. Ed. 185.

Both parties to this cause were not victims of Errion's fraud as facts do not show that Errion defrauded Appellants.

Appellants contend that both themselves and Appellee were innocent victims of frauds practiced separately upon each by E. R. Errion. Appellants admitted that Appellee was a victim of Errion's fraud. Appellee did not admit that Appellants were victims of fraud and in fact contended otherwise.

As to Appellants in Finding 6 (Tr. 19) the Court found that they had voluntarily purchased the note and mortgage from Errion and at the same time Errion had fraudulently misrepresented the validity of the note and mortgage to them. In settling findings Appellee pointed out to the trial court her view that a person could not consistently have voluntarily purchased a note and

mortgage and at the same time been induced to do so by fraud of the seller. The trial court thought otherwise and at Appellee's request specified in the findings the basis of fact in support of the fraud as follows (Tr. 20, Finding 6):

> "E. R. Errion fraudulently misrepresented said note and mortgage to plaintiff by representing it was a valid note and mortgage, knowing at the time he had procured the same by fraud which he had practiced upon the defendant."

While we do not think this inconsistency, if one, is germaine to a determination of whether or not the doctrine of comparative innocence should be applied we do contend that as a matter of law the facts found do not show actionable fraud and if a choice must be made that this court is for that reason justified in adopting the finding that Appellants voluntarily acquired the note and mortgage and not because of fraud.

At common law it has long been settled that assertions of bonafideness of notes and mortgages constitutes at best "dealer's talk" and not actionable misrepresentation of any material fact; so essential to form the basis of actionable fraud.

If, as we contend, the court in *Ackerman v. Bramwell Inv. Co.* (1932), 80 Utah 52, 12 P.2d 623, correctly held that the payee of a promissory note was not chargeable with actionable fraud in telling the assignee thereof at time of selling it to him that the note was "as good as gold and that he would see that the assignee did not lose a penny on the note" then Appellants in the case at bar were not defrauded by any assertions which

Errion might have made to them as to the validity of the note and mortgage. The trial Court's finding above quoted involves only "dealer's talk"; not a misrepresentation of a material fact. Appellants here were no more defrauded than the purchaser of a dragline who bought upon the representation of the seller that the dragline was "in good shape," *Getty v. Jett Ross Mines* (1945), 23 Wn. 2d 45, 159 P.2d 379, or the purchaser of a note from a bank when the bank teller assured him that the note would be paid at maturity, *Rardon v. Davis* (Mo. App., 1932), 52 S.W. 2d 193. Since the note and mortgage upon their face speak validity the assurances of Errion, particularly if impressive enough to be relied upon should have put Appellants on inquiry; not make them the "innocent" victims of fraud in the transaction.

Doctrine of comparative innocence is not applicable where note and mortgage are fraudulently procured in the first instance.

Assuming Appellants did have "clean hands" and did have so exhausted their legal remedy as to come into equity so as to assert affirmatively that an estoppel in pais be invoked against Appellee, such equitable doctrine should not be applied here against Appellee because she did not voluntarily entrust Errion with the note and mortgage but rather the instruments were fraudulently procured from her by fraud of Appellants' assignor.

If Errion had procured the note and mortgage from Appellee at the point of a gun or by duress such as blackmail Appellants we believe would not have the

temerity to urge the doctrine of comparative innocence. Procurement of the note and mortgage by fraud is no different than armed robbery or blackmail except in degree. In neither situation could it be said that the instruments were voluntarily entrusted and for this important fact the doctrine of comparative negligence cannot be invoked by Appellants.

It is to be observed that procurement of the note and mortgage from Appellee by fraud was admitted and not undertaken to be proven by Appellee. Also, it is to be observed that while the district court found Appellee negligent it did not find that Appellee voluntarily delivered the note and mortgage to Errion as in the case of Appellants voluntarily acquiring the note and mortgage thereafter from Errion. Nor, was Appellee found to have acted with lack of good faith or with indifference as in the case of Appellants (Tr. 20, F. 8).

This distinction between voluntarily entrustment and fraudulent procurement of choses in action in regard to applicability of the doctrine of comparative innocence was first made in 1893 in the old "lightning rod" cases. In *Hill v. Thixton* (Ky., 1893), 23 S.W. 947, the defendant had executed under fraud and duress a note together with a "certificate of no defense" and the assignee for value pleaded the doctrine of comparative innocence claiming he had relied upon the certificate and that the defendant, rather than he, should suffer the loss. In distinguishing a prior decision where in the certificate of no defense had been voluntarily given instead of having been fraudulently procured the Court said:

> "The case of *Wells v. Lewis,* 4 Metc (Ky) 269, cited against this view, was where neither the note nor the accompanying paper was attacked for fraud. The consideration alone of the note was sought to be impeached, and its makers, having voluntarily given the certificate that they had no offset, in order to give currency to their paper, would have been guilty of perpetrating a fraud on the innocent holder if defense had been allowed. *If the note and its accompanying 'letter of credit' were executed voluntarily, and free from imposition and fraud, then recovery should be had; if the note or its certificate of good character were not so obtained, then whatever defense, discount or offset, might have been used against the original obligee, may be used against the assignee."* (Emphasis ours)

Another reason why Appellee should not be estopped is that she did nothing to mislead the Appellants. All she did in the first instance was sign and deliver to Errion the note and mortgage under compulsion of fraud; nothing more. Had she thereafter voluntarily done something else such as to give "a certificate of no defense" or ask Appellants for an extension of time within which to pay the note then Appellee might properly be estopped from asserting fraud as a defense because by her conduct she directly misled Appellants. However, this is not the case at bar and serves as another cogent reason why the district court refused to invoke an estoppel in pais upon Appellee.

Before a misrepresentation can arise to form the basis for an estoppel in pais such misrepresentation must be outside of the face of the obligation itself. In *Securities Holding Co. of Beresford v. Christensen* (S.D., 1928), 219 N.W. 949, the assignee of a note admitted

that it had been fraudulently procured, just as Appellants do here, but then contended that because the maker of the note had given a written certificate authorizing any bank to purchase with no "offset or condition" that the maker was estopped from asserting the fraud in the procurement of the note. The certificate was obtained from the maker along with the note and the court treated both as and in effect one instrument. It then said:

> "In 21 C.J. 1143 it is said that where a person liable on a note states to a prospective purchaser or assignee that the obligation is valid and that there is no defense to it, he is estopped to resist payment in an action by such person who had taken the paper on reliance on his representation, but it is further said that 'to render this rule operative' the representations must be outside of the face of the obligation, and, even though they are thus disconnected, if they are made simultaneously with the execution of the obligation, so that there is in effect but a single transaction, no estoppel will arise.' "

See also:

American Nat. Bank v. A. G. Somerville, Inc. (1923), 191 Cal. 364, 216 Pac. 376.
First Acceptance Corp. v. Kennedy (Iowa, 1951), 95 F. Supp. 861, 878.

We have carefully reread each of the Washington decisions cited by Appellants in their brief and find without exception that each involves a situation where a person in position of this Appellee voluntarily and without the imposition of fraud entrusted negotiable or assignable instruments to an agent who breached his trust by selling to another completely innocent person.

For reasons that are apparent those cases as so cited by Appellants are not in point with the case at bar.

Although the facts are somewhat involved we invite the Court's attention to *Willett v. Central Yakima Ranches* (1923), 126 Wn. 587, 219 Pac. 20, as being close in point with the case at bar. In that case the assignee bank had taken a land contract (similar to a mortgage) as security for a promisorry note that was not endorsed by the bank's assignor. In rejecting the doctrine of comparative innocence for the universal rule that an assignee's title can be no greater than its assignor the Court said:

> "Again, the title of an assignee to a non-negotiable chose in action, assigned to secure the payment of an obligation, can rise no higher than its source. In this instance, as we have stated, the assignment was made by the original owners to secure the payment of a specifically described promissory note. This note, while delivered to the bank by the assignees, was not endorsed by them. Under the almost universal rule, the bank took the note subject to all of the defenses that attached to it in the hands of the original payee. (See note to *First Nat. Bank v. McCullough,* 50 Or. 508, 93 Pac. 366, 126 Am. St. 758, 17 L.R.A. (n.s.)"

Recovery in Washington under the doctrine of comparative innocence has been denied in the following cases:

Doub v. Rawson (1927), 142 Wn. 190, 252 Pac. 920.
Liska v. Beckmann (1932), 168 Wn. 489, 494, 12 P.2d 599.
Eastonville State Bank v. Marshall (1932), 170 Wn. 503, 17 P.2d 14.
Rumpf v. Barton (1894), 10 Wn. 382.

FINDINGS OF FACT ARE SUPPORTED BY THE EVIDENCE

Contrary to Appellants general contention the findings of the court below are amply supported by the evidence and were not induced by any erroneous concept of the law.

The evidence does show that Appellee knew she had with reluctance signed a note but did not realize until long afterwards that she had also signed a mortgage (Tr. 73).

Finding of Fact No. 7 (Tr. 20) is in reality a conclusion of law for the same reason the state court had found "holders in due course" to be a conclusion of law. *Glaser v. Connell* (1955), 47 Wn. 2d 622, 289 P.2d 364. Whether law or fact the finding is nevertheless correct in that Appellants' legal ownership of the note and mortgage was always subject to the fraud of their assignor.

As pointed out earlier no inference can be drawn to conclude that the district court in Case 3556 found that Appellants were the owners of the note just because it cancelled the note only as to the interest of their assignor.

Finding of Fact No. 8 (Tr. 80) to effect that Appellee had at no time conducted herself by any acts or omissions so as to mislead or prejudice Appellants and give rise to an estoppel is well supported by the simple fact that neither parties had contact of any nature with the

other. Although Appellants at all times had knowledge of Appellee, Appellee at no time had knowledge of the Appellants.

CONCLUSION

Appellee's fight to remove the fraudulently obtained mortgage as a cloud on the title to her Seattle home has been long and hard. In each encounter she has been biting at Appellants' heels, so to speak; with some but not complete success. The Appellee in her Case 3556 established the fraud but failed to bring home to Appellants actual knowledge. It didn't aid her res judicatawise but unquestionably induced the admission that the note and mortgage were tainted with fraud. In *Glaser v. Connell* (1955), 47 Wn. 2d 622, 289 P.2d 364, appellee, while not establishing the fraud, did strip Appellants of their status as holders in due course. With Appellants finally cut down to their true size—naked assignees of fradulent paper, Appellee, at least in the court below has been able to consolidate her gains in the prior litigation and end the five year battle for survival.

Appellee prays that this court in its wisdom affirm the judgment of the court below. There is no legal principle of res judicata and certainly no equitable principle of estoppel in pais that requires this court to reverse the judgment of the court below. We have refrained from speaking factualwise of comparative innocence but contend it is just the opposite to which Appellants by their brief would lead their court to believe. Suffice to

say, Appellee, for five long years and while in her eighties has fought "the fabulous rascal" on all fronts and that is more than Appellants can say.

Respectfully submitted,

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